



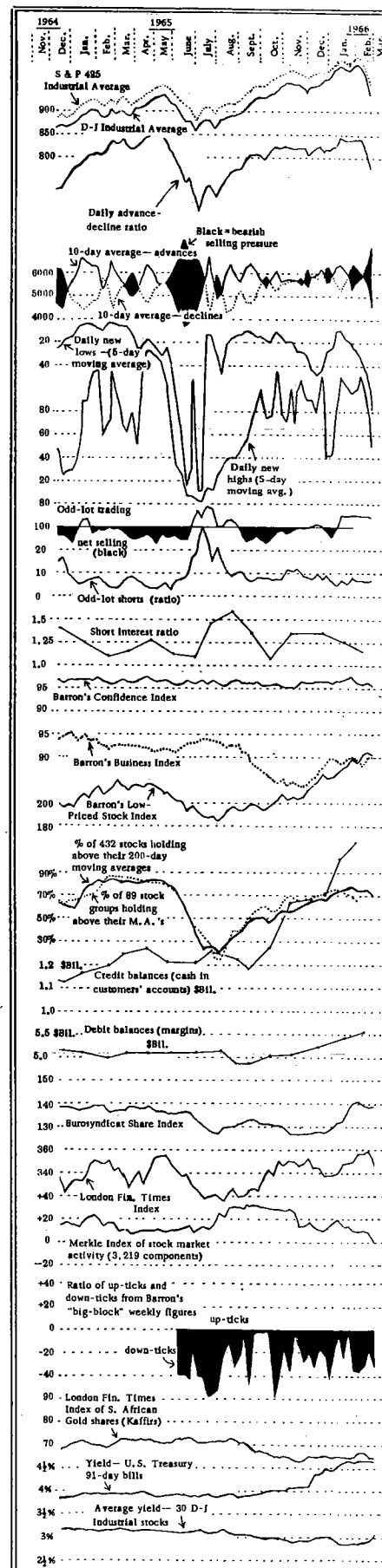
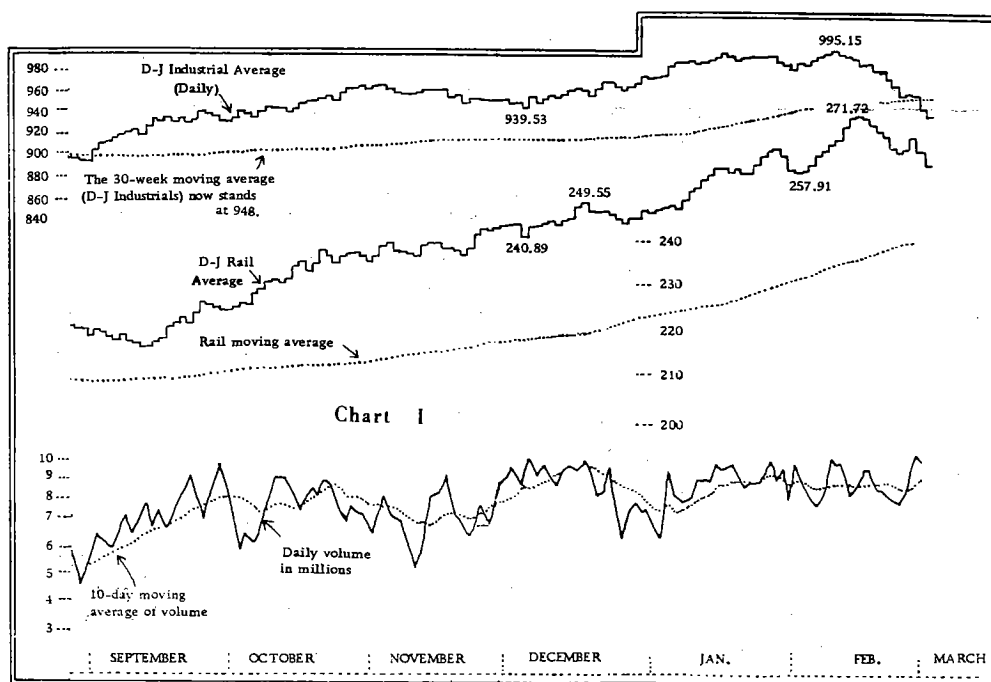
March 3, 1966

Letter 316

THE MARKET: There are times when the shadow of world events looms so large that the market student is tempted to hide behind his desk and merely await the verdict of Wall Street. This is about the way this writer feels now. I was one of the first to point to the forthcoming trouble in the money market, but the troubles (although still in the formative stage) have grown even more serious than I expected. I was dubious about the Vietnam situation two years ago; I am a good deal more dubious about it now. I was never sold on LBJ as a "political magician," and I have plenty of company today. I was worried about depletion of U.S. gold reserves and about the steady "demonitization" of the U.S. debt as far back as 1959-60, but I did not really think the situation would be allowed to go as far as it has.

The longer one toils in this business, the more convinced he is that no man or group of men can put all the facts, large and small, together and come up with "the answer." If this was so ten or twenty years ago, it is even more so today. It is true because we now live in a more complicated world, and it is true because our Government is now engaged in "manipulating" and "managing" the news to a greater extent than ever before. For instance, is there an economist alive who understands the full implications of the U.S. fiscal machinations, foreign exchange "swaps," monetary manipulations and changes in budgetary reporting? And if he knows enough to be sceptical, will he sound credible if he disagrees with the army of Administration "experts" who repeatedly assure us that the U.S. is continuing to follow the soundest policies?

What then, is the answer for the harried investor? In the end, this writer has always turned to the method which has proved itself most reliable throughout the years. That method is Dow's Theory. Being a Dow Theorist, I have not cared for the way the market has been acting all during 1966, and I have cared a good deal less for the action of the past month. What has been occurring is this: under the guise of excited, almost hysterical speculation in "high flyers" and "wonder stocks," the "big issues" have been sinking persistently. When I say big issues, I mean the giants or the type of stocks which comprise the D-J Industrial Average. Make no mistake about it, the Dow type stocks are very, very important, and their action is our best hint as to the



As a rule, investment money moves first, and the rest of the market follows.

The Rail Average has been putting on a far better performance than Industrials. For instance (see chart 1) on February 17 Industrials broke below their February low. But as of this writing, Rails have not yet penetrated their own February low of 257.91. The performance of the Rail Average in the period ahead will be most important in helping us to gauge the potential seriousness of the decline. If Rails can hold above their 257.91 February low, the odds will favor a rally and perhaps a substantial one. Conversely, if the Rails now weaken and break their February low, I would take this to be a most important danger signal.

In the last Letter I drew attention to the significance of the December, 1965 low. In the great majority of cases, when the Industrials turned down in the first quarter of the new year and violated the preceding December low, it was a bad sign for the coming year. On March 1 (Tuesday) Industrials penetrated the December, 1965 low of 939.55. I take this as a particularly bearish sign for 1966, and I urge all my subscribers to be warned (and act) accordingly. (I might add that on the same day Industrials dropped below their 30-week moving average for the first time since August, 1965).

What would constitute a true primary bear market signal? Unfortunately, as far as Dow's Theory is concerned a bear signal can come in only two ways: (1) Following a full reaction, if the subsequent rally fails to take one or both Average to new highs, and the next decline shatters the reaction lows on heavy volume, a bear signal will have been given. But since the current reaction is still in progress, this method of classification is still far off. (2) If the Averages continue straight down with no real upward correction (I might add that type of movement is very rare), then at the point where the two Averages break their last reaction lows it is correct to say that a bear market has been in effect. The last reaction lows were the June, 1965 lows of 840.59 and 187.29 respectively. Obviously, it would take almost a collapse to produce this type of bear signal.

Finally, I might add that neither Robert Rhea nor William Hamilton ever advocated waiting for an actual bear signal before selling. They suggested cleaning out when stocks were overvalued and when speculation was rampant. I have been insisting that those two conditions were in effect for many months now. Further, I have been recommending a position of 10% to 20% in gold equities and the rest in 91-day Treasury bills. Subscribers who have taken me seriously should be in good shape to weather any storm which may lie ahead. As for those with speculative holdings, I would suggest selling these on the basis of individual support levels or, if Rails break 257.91, I would suggest cleaning out all speculative positions.

NOTES AND QUOTES: From the Feb. 15 report of the First National Bank of Dallas: "The President's administrative budget for fiscal 1967 contains \$12,750,000,000 for interest on the Federal debt, or \$750,000,000 more than was budgeted for fiscal 1966. The latest Treasury report shows that the average interest on the debt is 3.73%. Each refunding or roll-over, as well as new borrowed money, adds to the cost."

From the Feb. 23 Janeway Service: "Any time sterling is sick, epidemic is a danger. And sterling is headed for the sick list again. Take this as a first warning, though an early one. Last year, sterling rode out the normal late-summer and autumn period of seasonal strain in great shape. We do not expect a repeat performance in 1966."

From the latest (March) Bank Credit Analyst by A. Hamilton Bolton: "Those who see a relationship between the money market barometer and stock market prices point to the inevitability of a bear market in stocks before much time goes by. Those who think that the only force motivating the direction of stock prices is earnings are equally adamant that the money barometer is no longer of significance in a world legislated by Keynesian economics, in a world in fact in which monetary inflation will be resorted to, to a greater and greater degree, as the need arises. Our Monetary Thermometer Consensus told us as long ago as last June that the patient was starting to run a fever. Few were willing to believe it. Now the evidence is everywhere—in the bond market, in commodity prices, in the increasing dilemma of Vietnam, in the measures taken to stem temporarily the balance of payments problem, in the last minute attempts to put together a new international currency (we call it the 'crummy cru')...."

From E. George Schaefer's Dow Theory Trader of Feb. 26: "Briefly, I don't trust the situation. The bull is getting old, the bear is getting stronger, and entirely too many new people who know nothing about stocks and who have no business being in the stock market are getting into it nowadays with all kinds of enthusiasm and bullishness at these high prices. Therefore, I would get out of all stocks, in fact, I would more-or-less 'dump' them, and put my money into 182-day Treasury bills. This would be my suggestion for 'playing it safe'. . . . In other words, if the Industrial Average decisively closes below its close of 953 today, a week from now, or next Friday, March 4, then I plan to sell everything in our two model accounts in anticipation of a bearish and irregular lower market for some time to come. Such an irregular decline could possibly be of 3 to 5 years in duration. Therefore, the week ahead might be an indication of the coming of the final end of one of the longest and most prosperous eras that the U.S. has ever had in its entire history. . . ." (Editor's note: This is the first time that Schaefer has turned bearish since 1949 or since he first predicted the beginning of the great post-war bull market).

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The U.S. is locked in a titanic struggle with the Communist world—but the Communists view the struggle as economic (men are expendable). As this writer sees it, the U.S. strategy is wrong, and we are being bled dry early in the fight. Under the "Rusk doctrine," the U.S. is to honor all commitments everywhere made by all Presidents and Congresses. And this while continuing to follow a "guns-and-butter" policy.

England, our once great ally, has been sinking into feebleness in an orgy of free spending and high living. Latest London plans call for a 33% cut in overseas defense, a 25% cut in overall military capabilities, a jettisoning of the Aden naval base. On top of this, the pound has now weakened again in the face of continuing British inflation (the 1965 cost-of-living in Britain jumped 5%, largest increase in a decade).

Meanwhile, DeGaulle follows what he believes to be France's only true course for survival. He wants U.S. armed forces off the Continent, feels that an integrated military force is no longer necessary. France is convinced that the U.S. is burning itself out in Asia, and that the Vietnam situation could threaten to draw Europe into a war that it neither believes in nor wishes to get involved in.

The isolation of the U.S. position is seen most dramatically in the fact that only S. Korea (which is under a U.S. aid program) has given any sizeable support in Vietnam. V.P. Humphrey's recent world trip proved almost embarrassing as nation after nation turned down our request for Vietnam aid. Typical of the "you do it yourself" response is seen in the attitude of the once fantastically militaristic Japan. Japan is now so disillusioned about war that it refuses to elevate its Defense Agency to ministry status, will not even vote for compulsory military service. Japan is terrified by the U.S.-Vietnam confrontation, wants as little to do with the war as possible.

The economic implications of the lone U.S. stand are ominous. The Vietnam war has arrived following years of U.S. deficit spending, years of gold losses and years of inflation. Seeing the gathering storm, the U.S. is now attempting to persuade the Committee of Ten in Europe to agree to a new international reserve currency. The currency is simply to be "legislated" into being, it is to have no gold base. The new "currency" might be expanded indefinitely with no need for further gold reserves. To disturbed European creditors, the U.S. sounds like the debtor who is preparing to welch on both his interest and his payments. Europe, piling up gold on its own, is not about to go along with any U.S. dream of an "international house of paper."

Conclusion: On March 1 Industrials violated both their 30-week moving average and their December, 1965 low. I consider this a bearish performance. If you have not yet followed my recommendation of a sheltered position consisting of cash and gold shares, I recommend that you do so as quickly as possible.

The Composite Chart shows the two leading industrial indices well off their 1966 highs. On February 24 (see Letter 315, page 2) the A-D ratio penetrated its December low. This move was confirmed on March 1 when Industrials violated their own December low. The A-D ratio has now wiped out all gains back to August, 1965; Industrials have erased all their gains back to October, 1965. Heavy selling pressure is indicated by the position of the 10-day average of advances over declines (solid black area). As noted in the last Letter, new lows are expanding sharply, while new highs are contracting.

The odd-lot statistics are also rather negative at this time. Unlike other recent periods, odd-lotters have stayed on the buying side throughout this decline. Furthermore, odd-lot shorts have not stepped up their shorting on the drop. Such action is negative and suggests that the downward trend has further to go. The great majority of declines of 5% or more have ended amidst heavy odd-lot shorting. Credit balances for January rose to the highest level in history, meaning that the public has a great deal of cash in its accounts. This would normally be bullish, but it does not jibe with odd-lot statistics and it will have to remain a mystery. The Merkle Index touched zero last week for the first time since 1962. If this broadly-based index goes minus next week, it will be a further bearish confirmation. The adverse spread between yields on U.S. Treasury bills and yields on the Dow remains very wide. One of the strange (and unpleasant) characteristics of the current situation is that bonds and stocks have declined together. Usually, bonds will rally sharply when stocks decline. Conclusion: The majority of indices indicate caution.

THE RULE OF THE GIANTS: Much has been written (perhaps too much) about the "forecasting" ability of General Motors. Nevertheless, it remains a fact that when GM has "topped out" and turned down in the past, it has not been too long before the rest of Wall Street followed. The GM-market relationship has worked often enough so that it cannot now be safely ignored, yet it would be foolhardy to use this "rule" as a method for pinpointing market turns. In the majority of cases, a downward trend in GM will ultimately exert its influence on the entire market. Exceptions usually turn out to be mistakes in the analysis of the trend of GM. For instance, it appeared that GM had topped out in October, 1963, but in retrospect this judgment proved to be incorrect (see chart). In mid-1964 GM surprised everyone by rallying to a new record high, and this was followed by new record highs in the Dow during 1965.

An analysis of the monthly chart shows that GM turned down in November, 1955, thus foreshadowing the "triple-top" of 1956-57. GM topped next in July, 1959, six months before the final peak in the Dow. Next GM hit a high in December, 1961, simultaneously with the Industrial Average. Most recently, GM recorded its high in October, 1965, and the stock has declined in the four months since then. Last week GM broke 100 for the first time in five months, thus providing a point & figure "sell" signal. We must now conclude that GM has turned bearish.

James Dines of N.Y.C. has recently uncovered a second "bellwether" stock, and this is duPont. Note that like GM, duPont turned down in 1955, thus rendering an early warning signal. DuPont performed worse than GM through 1956, and both of these stocks finally led the market down in 1957. DuPont topped next in August, 1959, five months ahead of the Dow. Again in November, 1961, duPont provided an early warning by turning down one month ahead of the Dow. Most recently, duPont topped in June, 1965, and last week duPont (see chart) broke the critical 226 level.

Conclusion: Tops and subsequent declining trends in both duPont and GM have (in the past) provided reliable indications of forthcoming trouble in the market. Evidentially, when the equities of these two giants, whose purchasing and selling power affects (directly or indirectly) almost everybody in the nation, are in a declining trend, the implications are so powerful that the entire market can be expected to follow.

In the present instance, until proved otherwise the common stocks of both duPont and GM must be considered to have turned bearish (duPont when it touched 234 in November, 1965; GM when it touched 100 on February 21, 1966). The market has been forewarned.

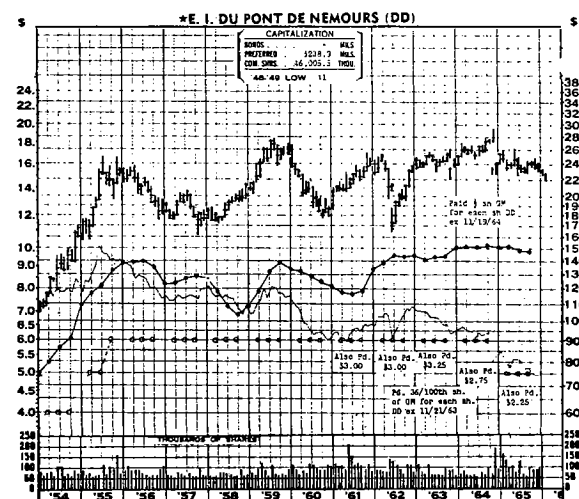
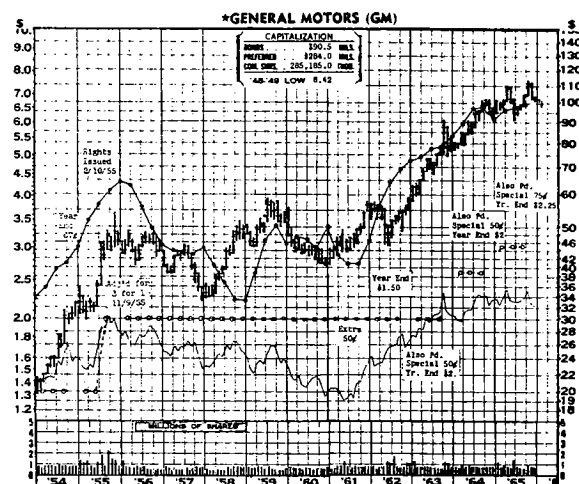


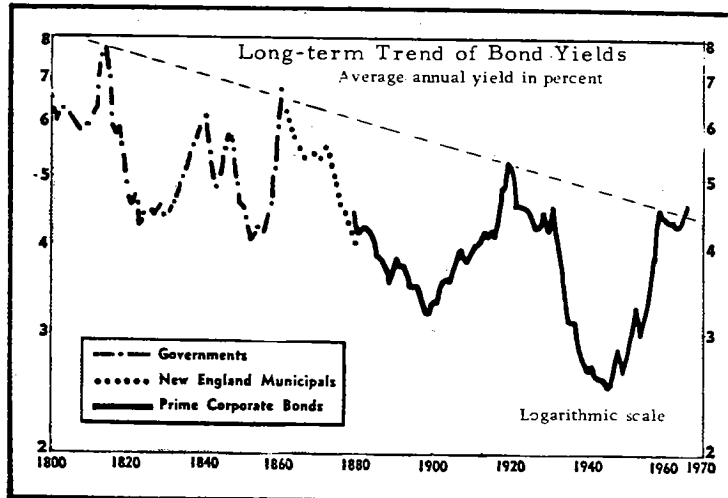
CHART OF THE WEEK: I doubt if any other analyst has written more about bonds and money rates over the past few months than I have. Nevertheless, I want my subscribers to be fully aware of the bond picture as it develops. The accompanying chart provides a superb perspective for the bond market. Note that since 1800, there have been four distinct bull markets in bonds, each reflected by a major decline in interest rates as shown on the chart. Since 1800 there have also been four bear markets in bonds, each identified by a major advance in interest rates as shown on the chart.

Currently, we are in our fourth great bear market in bonds. This chart is drawn to semi-logarithmic scale, which allows for correct comparisons of each of the major movements in bond yields. Interestingly, we note that each bear market in bonds since 1800 has been milder than the last and each had produced peak yields below the preceding peak. However, the long descending trendline running through the respective yield peaks has now been penetrated on the upside. This is a highly theoretical thesis, but it does suggest to me that we could be headed into a money situation which will prove to be more severe than most people suspect. It also suggests, contrary to what we read today, that the final phase of the long bear market in bonds (which began in 1946) is not yet near its end.

Conclusion: I continue to recommend that my subscribers place funds in short-term (91-day) Treasury bills rather than intermediate or long-term bonds. I have no doubt that we will see another major bull market in bonds one day; I do not believe that day has yet arrived.

STOCKS: I feel that this is an opportune time to provide my readers with a run-down on the 30 Dow stocks. I have listed each stock, its 30-week moving average level, a notation as to whether that stock is above or below its moving average and a final column noting whether the stock is above or below its 30-week moving average of relative strength. The last is an excellent device developed by Traders Research for classifying stocks as bullish or bearish on the basis of relative strength. These listings should provide readers with a "feel" for the undercurrent of the market as well as a list of "sell points" for the various Dow stocks. I would sell any stock which breaks below its moving average. (These statistics were taken from the daily chart book by Traders Research, 1431 Pearl St., Alton, Ill. 62003).

LATE NOTES: This is being written on the morning of March 3 (Thursday). The market has been dropping for 14 days. Industrials have lost 63 points without (incredibly) producing so much as a three point rally (on a closing basis) on any single day. The decline has been remarkably persistent and it has an ominous tone. Rails have joined in with a vengeance over the past few days.



	30 wk. moving average	stock above or below its M. A.	Rel. Strength above or below its M. A.
Allied Chem.	49	below	below
Am. Tel.	66	below	below
Alcoa	74	above	above
Amer. Can.	56	above	on it
Am. Tob.	39	below	below
Anaconda	77	above	above
Beth. St.	38	below	below
Chrysler	58	above	above
DuPont	239	below	below
East. Kod.	106	above	above
Gen. Elect.	112	below	below
Gen. Foods	83	below	below
Gen. Mot.	104	below	below
Goodyear	48	below	below
Int. Nickel	92	above	above
Int. Harv.	41	above	above
Int. Paper	31	above	above
Johns. Man.	54	above	above
Owens. Ill.	58	below	below
Proc. Gam.	71	below	below
Sears	65	below	below
St. of Calif.	77	below	below
St. of Jersey	79	below	below
Swift	51	above	above
Texaco	81	below	below
Un. Carbide	67	below	below
Unit. Airc.	78	above	above
U.S. Steel	51	below	below
Westinghouse	57	above	above
Woolworth	29	below	below

Particularly disconcerting to this writer is the utter complacency which has accompanied the decline. Analysts and writers seem to be almost unanimous in stating that "the correction is long overdue." Perhaps they are right, but no one, at this point, can prove that it is not the start of a bear market. The lack of odd-lot shorting has been remarkable. Based on all past precedent, the odd-lotter should be shorting heavily before this market is ready for its first full upward correction. In all, it's a good time to be out of the market.

Page 3 charts of GM and DD courtesy of Security Research, 211 Congress St., Boston, Mass. 02110.